

USURY REDUX:
NOTES ON *THE SCHOLASTIC ANALYSIS OF USURY* BY JOHN T. NOONAN

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I summarize the key points of the scholastic theory of usury following The Scholastic Analysis of Usury by John T. Noonan. Usury is the sin of taking interest on a loan without a just title. According to Scholastic moral theology, interest on loans may be justified by the extrinsic titles to damnum emergens and lucrum cessans, i.e. for losses incurred or for profits lost. Implications of this teaching are discussed with regard to other contracts, such as partnerships, the census contract, bills of exchange and “dry exchange,” insurance contracts, and the so-called triple contract. Also discussed are the changes in the practices of confessors that occurred between 1822 and 1836.

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Last year I wrote a working paper called “Money for Nothing: The Sin of Usury,” in which I summarized the teaching of the Catholic Church on usury and suggested that what appeared to be a change to the teaching on usury was in fact merely a change in practice justified by fundamental changes in the economy over the last five hundred years. That essay errs only in that it fails to recognize the complexity of economic life in the late middle ages, especially that in northern Italy in the thirteenth, fourteenth, and fifteenth centuries, and the depth of understanding of the Scholastic theologians on economic matters, especially as they pertain to usury. My only defense is that I am neither a theologian nor a historian, and it was my awareness of these shortcomings that prevented me from submitting it to a journal for peer review. I am still neither a theologian nor a historian, but sometimes a good book can go a long way towards filling the gaps. In this case, the book is *The Scholastic Analysis of Usury* by John T. Noonan (1957). This masterpiece of scholarship surveys the development of the teaching on usury in Scholastic theology and canon law. This essay is a reappraisal of my original thesis in light of this book, and page citations refer to it unless specified otherwise.

“Notorious Public Usurers”

It is essential to any discussion of usury to identify the subject of the Church’s objection. “Notorious public usurers” were public moneylenders, typically Jews and lombards,¹ who loaned

¹ Cf. Noonan, p. 34.

money at interest rates of 35%.² Noonan tells us that merchant bankers who provided credit at moderate interest rates and who paid modest interest on deposits, while occasionally viewed with suspicion, were not on the same social footing as usurers.³ Importantly, interest rates charged by merchant bankers were substantially lower than those of public usurers.⁴ As the economy developed, other contracts similar to loans emerged, such as the *census* and the triple contract, that provided credit to borrowers at interest rates of 5%. These contracts were accepted as licit by moral theologians and Catholic authorities did not object to the provision of such credit at those interest rates, though they would object when those contracts were abused to disguise usury. While some of the more rigorous theologians occasionally objected, neither Catholic authorities nor the public conscience were disturbed by the moderate interest rates. On this point, Noonan suggests that there may have been a real divergence on the morality of exchange between the leading theologians and the merchants.⁵

Why is interest paid on a loan? There are several possible reasons: for the use of money; because of the bargaining power of the lender; for the opportunity cost of the lender; for expected inflation; for default risk; or for the labors and expenses of the lender. Usury is committed when compensation is demanded for the use of money itself, either as fees or as interest payments. The lender commits usury when he demands more in interest payments and fees than is morally justified, and he is able to do this when he is in a superior bargaining position vis-à-vis the borrower. This can easily occur in loans to the poor, who are forced to borrow while the lender does not need to lend, but it may also occur in loans for large commercial enterprises that can only be financed by one or a handful of large banks, who are then in a position to demand more in fees and interest than is warranted by any just titles. Noonan neatly summarizes the teaching: “usury, the act of taking profit on a loan without a just title, is sinful.”⁶

² Cf. p. 294.

³ Cf. pp. 191-92.

⁴ Cf. p. 192.

⁵ Cf. p. 192.

⁶ p. 400.

Scholastic theology traditionally recognizes two titles for which compensation may be paid on a loan: *lucrum cessans* (“profit ceasing”) and *damnum emergens* (“loss occurring”). Interest paid as compensation for the opportunity cost of the lender, expected inflation, default risk, or for the labors and expenses of the lender listed falls within these two titles. Such interest payments are morally permissible and not usurious. Compensation for opportunity cost is justified under the extrinsic title *lucrum cessans*, provided there were real opportunities to invest that were forgone by the lender. Compensation for expected inflation is justified by the title to *damnum emergens*, but was generally unknown during the middle ages, as inflation is a modern phenomenon. Of course, the theologians were well aware that prices fluctuate depending on economic conditions—even recognizing that they were jointly determined by supply and demand⁷—but such fluctuations were neither predictable nor persistently upward as they are today. Compensation for default risk could be justified under *damnum emergens*, but was not allowed at the time, since debts were not excused in the case of default and the obligation to repay the loan remained with the borrower. Debts could not be wiped away by declaring bankruptcy. Compensation for the labors and expenses of the lender are also justified by the extrinsic title of the *damnum emergens*.

The title to *lucrum cessans* is nearly identical to the economic concept of opportunity cost, though there is an important distinction. *Lucrum cessans* is the claim to profit lost by forgoing an investment opportunity; opportunity cost is the cost of forgoing the next best alternative, which may not necessarily be an investment opportunity. For example, it may be the case that I have no profitable investment opportunities, but I would like to spend my money taking my family on an expensive vacation. If, instead of spending the money, I choose to lend it, I must forgo my vacation. In this example, the opportunity cost to lending is the value of the vacation that I would have otherwise taken, but there is no lost profit, so it seems there is no claim to the title of *lucrum cessans*. Whether the meaning of *lucrum cessans* can or should be broadened to account for this possibility, or whether there is some other title under which I could claim compensation in this example, is a matter for theologians to decide, though it does not seem that any compensation is justified under either the title of *lucrum cessans* or *damnum emergens*.

⁷ Noonan notes that “Henry of Hesse [d. 1397] expressly declares that prices are determined by the joint influence of supply and demand.” p. 84.

Opportunity Cost, Inflation, and Default Risk in the Middle Ages

My original thesis was that moderate interest is justifiable in the modern economy as compensation to the lender for opportunity cost, inflation, and risk of default, as well as the costs of administering the loan, but these costs may not have been significant in the economic conditions that prevailed in a typical medieval economy. If this is the case, then little or no interest could be justified, and any interest charged would be excessive and usurious. Noonan provides evidence that supports this thesis.

The practice in extending loans during the middle ages was to presume that there was no the title to *lucrum cessans* unless there was evidence to the contrary, and Noonan provides some evidence that suggests that the opportunity cost of lending was zero in many cases. First, he notes that churches and monasteries often had large sums of money on hand: “many churches and monasteries were under a constant pressure to find suitable investments for their funds. . . . The papacy itself often had large idle sums on deposit in banks.”⁸ Second, he tells us that lending at zero interest would not have prohibited investment, since all such institutions could have entered into partnerships (*societas*) if profitable investment opportunities existed. The *societas* was “a great and universal form of licit investment in commerce throughout medieval Europe.”⁹ Noonan also tells us that, contrary to what the Marxists would have us believe, there was no objection to seeking profit in Catholic moral theology¹⁰ and that there was no moral objection to partnerships in which one partner supplied the labor while the other supplied the capital.¹¹ With no moral impediment to seeking profit and a perfectly a legitimate investment vehicle, the most plausible explanation why large sums of money would remain idle is because no profitable investment opportunities existed. The existence of such opportunities, of course, depends on economic conditions, so this would not have always been the case—it does not seem to be the case among the merchant-bankers of Florence, Venice, and Genoa in the later middle ages—but this evidence suggests that it was the case in the earlier middle ages and perhaps in other regions even in the later middle ages.

⁸ Noonan, p. 14.

⁹ Noonan, p. 133.

¹⁰ “It must be clearly understood that there is no scholastic opposition to profit as such.” p. 32.

¹¹ “Often one partner will invest money alone, the other labor alone. . . .” Noonan, p. 134.

Inflation, by which is meant an increase in all prices, is a phenomenon of the modern economy. The persistent upward trend in inflation did not begin in the United States until 1960, and predictable annual inflation rates of 2-3% began in the early 1980s. Perhaps the earliest instance of widespread inflation would be that of Spain in response to the influx of gold from its American colonies. Persons living in the middle ages would not have expected the general price level to rise, but they were well aware that prices fluctuated with economic conditions, and recognized that such changes in prices could bring losses to creditors. As an example of this, Scholastic theologians recognized a title to *venditio sub dubio* in their treatment of credit sales. In a credit sale, a good is received today and paid for at a later date. The title to *venditio sub dubio* is a title of the creditor to receive a higher payment at the later date because the value of the goods sold increases at the time of payment. A credit sale is a single transaction, but it can be thought of as two separate transactions: the seller loans money to the buyer, who then buys the good and pays off the loan at a later date. The difference between the prices of the good today and at the future date is effectively the interest on the loan, so such contracts were open to abuse by the unscrupulous. In *In civitate*, Pope Alexander III recognized the title to *venditio sub dubio* as licit when there was real doubt as to the future value of the goods, though Pope Urban III clarified that credit sales at much higher prices were to be considered usurious.¹² While theologians at the time did not apply this title to loans (*mutuum*), the title to *venditio sub dubio* clearly recognizes that both that prices could change with economic conditions and that when such changes caused or were expected to cause a loss to the creditor he had a title to compensation. The title to *venditio sub dubio* is due to a loss incurred by the lender and falls under the broader title of *damnum emergens*. While this title was it was not generally applied to loans, the fact that the popes recognized that usury could be committed in credit sales indicates that they recognized the connection between the two types of transactions, so it is plausible that what could be claimed in one transaction could be claimed in the other.

The risk of default presents a real cost to the lender, and these risks are significantly different in the modern economy. Scholastic theologians carefully distinguish between the two types of risk of default: *perticulum sortis* is the risk faced by a lender who agrees to forgive the debt if the debtor fails to repay because of some misfortune; *perticulum mutui*, as Noonan calls it, is the risk

¹² See Noonan, pp. 90-91.

faced by a lender who does not agree to forgive the debt in the event of misfortune, instead the debt.¹³ Noonan explains that *perticulum sortis* is the risk faced by an insurer and is generally favored by theologians as a title for compensation, presumably falling under the title *damnum emergens*; *perticulum mutui* is the risk faced by a lender who does not agree to forgive the debt, and this not generally recognized as a valid title.¹⁴

The consequences of nonrepayment of a loan changed dramatically with the abolition of slavery, effectively changing the risk of default faced by lenders from *perticulum mutui* to *perticulum sortis*. In the modern economy, a debtor in default may declare bankruptcy and have his debts substantially reduced or wiped away, at the cost of the creditor. In the event of bankruptcy, the creditor is forced to forgive the debt; the risk is that of *perticulum sortis*. This was not so in the middle ages, where the debtor remained in debt. Noonan summarizes the argument of St. Bernardine against compensation for risk of default: “since the debtor always remains obliged to indemnify if he defaults, the peril of the creditor is not real.”¹⁵ The debtor does not owe compensation prior to default, but, in the event default, he remains liable not only for the full amount of the loan, but also for any legal expenses incurred by the creditor in recovering what is rightfully his. A debtor could end up debtors’ prison or as an indentured servant or slave. The option to declare bankruptcy was not available to debtors at that time, and as a result the costs arising from risk of default is significantly different now than it was to creditors in the middle ages.

The *perticulum mutui* faced by creditors is mitigated by several factors, and the costs represented by this risk would depend both on the likelihood of these events and how such events were treated in law and practice. In the middle ages it was common to attach a pledge to loan, either in the form of collateral or as a guarantee by a third party, and this would significantly reduce the potential costs faced by the lender in the case of default. Noonan tells us that pledges demanded by public usurers were usually “worth much more than the loan.”¹⁶ In the event of default, the creditor either receives property worth more than the loan itself or a payment by a

¹³ Noonan, p. 129.

¹⁴ Noonan, p. 129.

¹⁵ Noonan, p. 131.

¹⁶ Noonan, p. 129.

third party for the amount of the principal. For loans on which the creditor did not demand a pledge, the debtor would remain in debt even in the case of default, so the creditor would face only the risk that the debtors would either flee or die before the loan was repaid, and the potential costs to the creditor of the risks of death or flight of a debtor would depend both on the contract itself and how such contracts were treated in law. For instance, when debt was inherited by the children or other relatives of the debtor in the event of death or flight, the actual risk faced by the creditor would have been mitigated and even insignificant.

Scholastic theology has long recognized the validity of titles for compensation for *lucrum cessans* and *damnum emergens*, but the amount of compensation that is justifiable under these titles has changed dramatically with the changes in economic conditions. Where there was once a presumption against *lucrum cessans*, the plentitude of investment opportunities in the modern economy justifies a presumption in favor of it; compensation for the cost of inflation to the lender is justified by the title to *venditio sub dubio*; and the abolition of slavery has effectively transformed the risk of default from the invalid title to *periculum mutui* to the valid title to *periculum sortis*. While the changes in the economy left the Scholastic teaching unaffected, they did bring about changes in the practice of confessors, and it is these changes that are often mistaken for a change in the Church's teaching on usury.

Changes in the Practice of Confessors

The change in the practice of confessors came about through a series of sixteen decrees made by the Holy Office between 1822 and 1836 in response to questions about the absolution of penitents. Prior to this time, the practice had been to withhold absolution from penitents until they restore any gains that they had made in lending that were not justified by titles to either *lucrum cessans* or *damnum emergens*. It is apparent from the questions that, in practice, the title to *lucrum cessans* at that time could only be claimed with reference to an actual investment opportunity. The questions asked of the Holy Office establish that it is permissible for confessors to absolve penitents who receive the interest permitted by civil law without making restitution. All information on the decrees listed here are from Noonan and sources quoted by him. I include them here because these decrees are essential to understanding how the practice of confessors changed:

[Decree I. In 1822, a woman of Lyons “gave her capital to certain persons with the agreement that they pay her the interest rate prescribed by civil law.” She appealed her confessor’s refusal of absolution and the sacraments.] The Holy Office, judging the appeal, declared that “a response will be given at a suitable time”; that meanwhile, however, restitution was not necessary; and that the woman might receive the sacraments.

[Decree II. In 1830, the confessors of Rennes were absolving penitents who had lent their money to businessmen at interest with the proviso that they were willing to submit to a papal decision on the matter and make restitution should it become necessary. The Bishop of Rennes asked the Holy See two questions: should the practices of these confessors could be approved? and should the more rigid confessors should conform to these practice?] Pius VIII, after consultation with the Holy Office, personally replied “To the first question, they are not to be disturbed. To the second, it is answered in the first.”

[Decree III.] A perplexed vicar-general asked, “Whether a confessor sins, who sends away in good faith a penitent, who demands from a loan the gain allowed by the civil law, apart from any extrinsic title of *lucrum cessans* or *damnum emergens* or extraordinary danger?” [The Holy Office responded] “*Non esse inquietandum*” (“They are not to be disturbed”) provided he is ready to obey a decision of the Holy See.¹⁷

[Decree IV.] A troubled theologian, Denavit, . . . declared “The undersigned writer, thinking it licit by no contract to withdraw from the doctrine of Benedict XIV, denies sacramental absolution to priests who contend that the law of the prince is sufficient title for taking something beyond the sum lent apart from *lucrum cessans* or *damnum emergens*.” In answer to his question if his conduct was, then, too severe toward these priests, the Holy Office again replied “*Non esse inquietandos*.”

[Decrees V-XI. Six more decrees confirmed these responses, and two more in response to questions from the Bishop of Viviers affirm the permissibility of the interest rate authorized by civil law on loans to businessmen.]

[Decree XII. The monks of the collegiate chapter of Locarno could not find a suitable investment at more than 2.5%, and asked (1) if they could lend the money at the legal rate of interest; (2) if this permission could be extended to all churches, monasteries, and wards in

¹⁷ De Vie, *Litterae monitoriae*, in Migne, *Theologiae cursus completes*, XVI, col. 1065. Quoted in Noonan, p. 379.

similar positions; and (3) “whether such contracts are sufficiently justified by civil laws and forms which now generally ratify them and order them fulfilled, and also by the common and tacit consent of the people which, by now an ancient custom, seems to substitute these contracts as more convenient in place of others more involved and difficult?” The Holy Office responded “*Non esse inquietandum.*”]

[**Decrees XIII-XV.** Refer questioners to earlier decrees; decree XV notes that “good faith is always supposed” in those taking interest on the grounds of the legal title.]

[**Decree XVI.**] The Bishop of Viviers asked what attitude he should adopt toward those of his clergy who preached that the legal title was clearly valid, omitting any reference of the possibility of a future decision of the Holy See. Cardinal Gregorio, the Grand Penitentiary, wrote to him explaining the intention of the earlier decisions: “The Sacred Penitentiary wished to define nothing at all about the question, debated by theologians, of the title derived from the law of the prince; but only to provide a norm which confessors might safely follow in regard to penitents who take a moderate profit determined by the law of the prince, *with good faith and ready to accept the commands of the Holy See.*

Those, therefore, who in preaching teach absolutely that it is licit to profit from a loan by title of the civil law . . . define by private authority a question which the Holy See did not yet wish to define.¹⁸

Noonan notes that these decisions were met with considerable controversy among theologians. Did the civil law create a just title to interest other than *lucrum cessans* and *damnum emergens*? Or did the prevailing rates of interest in law and in the marketplace effectively provide a common estimation of the values of those titles, relieving penitents of the burden of calculating such titles according to their private circumstances?

Defenders of the scholastic tradition pointed out that “the general permission to take interest can be understood as an extension of the title to *lucrum cessans* and need involve no abandonment of old principles.”¹⁹ Noonan also notes that

¹⁸ Noonan, pp. 378-81.

¹⁹ Noonan, p. 377.

“Their contention had particular cogency in view of the enormous quickening of economic life at the beginning of the nineteenth century. The Industrial Revolution, already in full progress in England, now began to affect the continent as well, and the Holy Office decrees coincide with the acceleration of its influence there.”²⁰

There is a recognition at the time that lending in the emerging economy entailed an opportunity cost and entitled on to a claim for *lucrum cessans*; the moral analysis of lending changed from a presumption against the existence of a profitable investment opportunity to a presumption in favor of one, and the practice of confessors adjusted accordingly. Interestingly, these decrees also coincide with the abolition of slavery—outlawed by Great Britain in 1833—though the implications of this for the risk of lending and the transformation of risk of default do not seem to be recognized either by Noonan or by the authors he surveys.

***Vix Pervenit* and the Teaching on Usury**

The last *ex professo* statement on usury by a pope was the encyclical *Vix pervenit*, promulgated on November 1, 1745 by Benedict XIV, about 75 years prior to the changes in the practices of confessors. This encyclical affirms the traditional teaching on usury. Regarding usury, the pope states

“The nature of the sin called usury has its proper place and origin in a loan contract. This financial contract between consenting parties demands, by its very nature, that one return to another only as much as he has received. The sin rests on the fact that sometimes the creditor desires more than he has given. Therefore he contends some gain is owed him beyond that which he loaned, but any gain which exceeds the amount he gave is illicit and usurious.” (*Vix pervenit*, 3.I)

The meaning of “gain” here does not prohibit any interest, for in the same encyclical, Benedict clarifies that

“By these remarks, however, We do not deny that at times together with the loan contract certain other titles—which are not at all intrinsic to the contract—may run parallel with it. From these other titles, entirely just and legitimate reasons arise to demand something over and above the amount due on the contract. Nor is it denied that it is very often possible for

²⁰ Noonan, p. 377.

someone, by means of contracts differing entirely from loans, to spend and invest money legitimately either to provide oneself with an annual income or to engage in legitimate trade and business. From these types of contracts honest gain may be made.” (*Vix pervenit*, 3.III)

There is no title intrinsic to a loan for compensation beyond the principal, i.e. no compensation is due for the use of money itself. Interest and other fees, if they are charged, must be justified by titles extrinsic to the loan.

There are two important points about the wording of the encyclical. First, the reference to the extrinsic titles situates the teaching within the framework of Scholastic theology; it cannot be interpreted apart from that tradition. Second, the fact that the titles to *lucrum cessans* and *damnum emergens* are not explicitly named allows for a flexibility, either in the definition of these categories or in allowing for the possibility there may exist other titles for which compensation may be justified, depending on economic conditions. However, the situation of the encyclical within the Scholastic tradition, leaves little doubt that the traditional titles are valid.

The changes in the practice of confessors allowed the *mutuum* to become the common form of credit in Catholic areas of the world. Prior to these changes, other contracts had been used in order to avoid the suspicion of usury, though these contracts, in their similarity to loans, were open to the same abuse. Theologians had long recognized the potential for abuse in *census* contracts, foreign exchange contracts, and the so-called triple contract, and various Popes had condemned the use of such contracts to disguise usury.

***Cum onus* and the *Census* Contract**

A *census* contract is an exchange of money for the fruits of productive property, originally attached to a piece of land. The seller of a *census* owns the property and by extension the fruits of it, and the buyer purchases these fruits. While the *census* is a sale, it is similar to a loan, in which the seller, who receives money, is the borrower, and the buyer, who receives an annual return, is the lender. Unlike a *mutuum*, the returns to a *census* were not considered interest and the contract carried ordinarily carried little suspicion of usury. However, as theologians probed the basis of the *census* they recognized its similarity to a loan, and that a *census* contract could be written in such a way so as to be formally indistinguishable from a loan. As such, the theologians recognized that the *census* contract could be used to disguise usury.

The concept of the *census* was expanded over the centuries as theologians question its foundations. Could any productive property be used as a basis? Could the property be mobile? Could a *census* be specified in terms of the value of the goods to be returned instead of the goods themselves? Could the seller of the *census* be guarantee a constant return, such as the average value of the fruits of the property, instead of a variable return? Could a *census* be based on the tax revenue of a State? Could a *census* be redeemable by the seller? To all of these questions, the Scholastics ultimately answered yes. A census did not have to be based on land and could be based on the tax returns of a State or on a person; the returns could be specified as constant monetary returns; and the *census* could be redeemable by the seller. The redemption by the seller allowed him to repurchase the rights to the property, or, effectively, to pay off the loan. A *census* based on a person specifying constant monetary returns that is redeemable by the seller is nearly indistinguishable from a *mutuum*, though subtle differences would remain in how these contracts were treated in law. What would if the base was no longer productive? In particular, what would happen with a personal census if the person became incapacitated and no longer able to work? Noonan tells us that “Alexander Lombard, Joannes Andrae, and Panormitanus make explicit what is probably the common assumption: the purchaser of the census runs the risk of sterility of the census base.”²¹ Where this distinction was maintained in law, the two contracts would differ in the event that a person became unable to work: if he had sold a *census* based on his person, then he would not be obligated to make a return to the buyer; if he had received a *mutuum*, then he would be obligated to pay interest to his creditor in spite of his condition.

In order to curb abuses of the census contract, Pope Pius V issued the bull *Cum onus* on January 19, 1569. Noonan summarizes the encyclical:

“The Pope begins by saying that the *census* contracts daily celebrated not only do not keep the limits set by his predecessors, but show a manifest contempt for the divine law. He then declares that no *census* may be constituted except on a fruitful, immobile good, specifically designated to pay the census returns. He invalidates all guarantees of *census* by the seller. He orders that every *census* be redeemable by the seller, and that, on the other hand, no buyer force an unwilling seller to redeem them. In a word, the personal, the guaranteed, and

²¹ Noonan, p. 158.

mutually redeemable *census* all are outlawed. All contracts not observing these rules, the Pope says, are ‘to be considered usurious.’”²²

Navarrus, a leading theologian and defender of the bull, believed that personal, redeemable *census* was a violation of natural law, but the majority of theologians of the day rejected this opinion. Noonan tells us that

“The majority of theologians . . . held that the principal requirements set forth by the Pope were matters of positive, not natural, law. A positive promulgation by the Pope had to be received by either the governments or the common practice of a country in order for it to retain the force of law. No country received *Cum onus*. St. Alphonsus Liguori states that the bull had no force in southern Italy, Spain, France, Belgium, Germany, or even Rome itself.”²³

Comments by Navarrus show that he opposed the personal, redeemable, guaranteed *census* because such a contract, so similar to the *mutuum*, was a cause for scandal and a method of “hiding usury.”²⁴ Thus, while the bull did not have its intended effect on law, the public recognition by the Pope that the personal, redeemable, guaranteed *census* was nearly identical to a loan and could be used to disguise usury is an opinion that seems to have been accepted by everyone.

In eam and Dry Exchange

A bill of exchange is an exchange of a quantity of currency at one time and place for another currency at another time and place. A bill of exchange can be thought of as two separate contracts: a loan of a certain quantity of domestic currency today and an agreement to exchange domestic currency for foreign currency at a future date, which is known today as a *forward* contract. Additionally, there is the fact that the exchanges take place in two different locations, which introduces the costs and risk of transportation of the currency into the moral analysis, though a bank would not ordinarily have to transport the currency in order to complete the transaction.

²² Noonan, p. 237.

²³ Noonan, p. 238.

²⁴ Noonan, p. 238.

A loan can be effected through the use of two bills of exchange in what is known as dry exchange. For example, a person exchanges \$100 in New York today with a bank for 115£ to be paid in London six months from now. A second bill could then be written for 115£ to be paid by the person in London six months from now in exchange for \$130 to be received by the bank in one year. Note that there is no restriction that the date that the contract is written must coincide with any of the dates of exchange, nor is it necessary that the person travel to London since the 115£ paid by the person in the second bill cancels out the 115£ received by him from the first. Both bills of exchange could be written at the same time, and the net effect of the two bills is for the person to receive \$100 from the bank today in exchange for \$130 to be paid in one year, or a one year loan at 30% interest.

On January 28, 1571, Pope Pius V directed the encyclical letter *In eam* against the use of foreign exchange contracts to disguise usury through dry exchange. Noonan summarizes the teaching of the encyclical

“The bull declares that the useful and necessary operation of exchange has been abused and made usurious by some avaricious persons. The Pope, therefore, condemns all dry exchange, by which, he says, are meant contracts taking the form of exchange in which either bills of exchange are not sent to another place or, if they are sent, are not paid there, but return empty to be paid by the seller of the bill in the same place, as it was agreed or at least certainly intended by both parties. In addition to these condemnations, the Pope, to take away any opportunity for sin, prohibits exchanges made to any but the next fair, and also the fixing of standard interest rates. The penalties for violating the bull are to be the canons against usurers.”²⁵

The competitive nature of modern foreign exchange markets has eliminated the possibility of dry exchange in developed economies. In such markets, interest rates and exchange rates are fundamentally related by the covered interest parity condition

$$(1 + i) = (F / S) (1 + j)$$

Here i is the domestic interest rate, j the foreign interest rate, F is the exchange rate on a forward contract, and S is the exchange rate in the spot market. When the exchange rate on the forward contract is equal to that of the spot market, $F = S$ and the condition implies that the foreign

²⁵ Noonan, p. 333.

interest rate must be equal to the domestic interest rate. Competitive markets limit the interest that can be made on two bills of exchange to the ordinary domestic rate of interest.

***Detestabilia avaritia* and the Triple Contract**

The “Triple Contract” or *contractus trinus* is a combination of three contracts that effectively transforms a partnership into a loan. The first contract was the *societas* or partnership itself, in which an investor would invest his capital with a partner. Insurance had arisen in the fourteenth century in conjunction with maritime trade. The second contract was an insurance contract in which the partner insured the investor’s investment against loss: the partner would be liable for the investment should the partnership fail. The third contract was a second insurance contract, in which the investor exchanged the variable returns of the partnership for a guaranteed fixed return. Through the use of these three contracts, the investor has effectively become a lender and the partner a borrower: the investment is the principal lent in exchange for a fixed return, and the borrower is liable for the full amount of the principal in the event of default. When the transaction is understood in these terms, the insurance contracts are properly called *swaps* in financial markets and the second contract—insurance on the principal in a loan—is a *credit default swap*. In the sixteenth century, the triple contract is commonly called “the 5 per cent contract” in reference to its typical interest rate, but this term comes to refer to the *census* contracts in the seventeenth century. The triple contract is successfully defended and promoted by John Eck, who wrote his *Tractatus de contractu quique de centum* in 1515,²⁶ and it is rapidly adopted and popularized throughout Europe in the sixteenth century.

Like the *census*, the *contractus trinus* becomes popular in part because it avoids suspicion of usury, and like the *census*, theologians recognize both its similarity to the *mutuum* and the potential abuse of it to disguise usury. It is against such abuse that the Pope Sixtus V directs the bull *Detestabilia avaritia* in 1586. The pope

“damns and proscribes all and any contracts, agreements and pacts afterwards to be made, by which it is guaranteed to persons giving money, animals, or any other things in the name of a *societas* that, even if in some fortuitous case, disaster, loss, or lack happens to occur, the principal or capital will always be safe and restored entire by the partner receiving it We

²⁶ Noonan, p. 209.

decree that contracts, agreements, and pacts of this kind are thought to be illicit and usurious.”²⁷

The pope then declares that those who continue those who use such contracts to exact either the capital invested or the fixed returns on that investment *after* the capital has whole or in part perished or been lost by a fortuitous event incur the penalties against manifest usurers and moneylenders. It is important to note that the risk faced by the partner or borrower in this contract is *periculum mutui* and not the *periculum sortis* faced by borrowers today, who have the protection of bankruptcy.

The question at hand is whether the indemnification against loss to the investor by his partner effectively destroys the partnership. In order for a partnership or *societas* to exist, is it necessary for every partner to bear at least some of the risk? Or is it possible that one can indemnify himself against all risk and yet remain a partner? The majority of theologians at the time agreed that it was possible for a partner to indemnify himself against all risk and yet remain a partner, and thus the matter pertained to positive, not natural law. The prevailing opinion is that of Conrad Summenhart, summarized by Noonan, who argued that

“the assumption of risk by the capitalist does not constitute the essence of the partnership.

The partnership is essentially constituted by the association of fund and skill for a common purpose. Similarly, the assumption of risk by a borrower is not the essence of a loan; a loan consists essentially in the borrower’s acquisition of loaned property.”²⁸

Because the content of the bull pertained to positive, not natural law, the strictures against the triple contract would only apply in those regions that received the bull into law. Though the bull did not outlaw the triple contract, it recognized the similarity of this contract to the *mutuum* and in it the potential for abuse, and these opinions were accepted without question. While usury was proper to a *mutuum*, it was not exclusive to it, and the potential use of *census* contracts, dry exchange, or the triple contract to disguise usury is plainly taught by the popes and recognized throughout the Catholic world.

Usury and the Theory of the Just Price

²⁷ Quoted in Noonan, p. 220.

²⁸ Noonan, p. 207.

One point to which Noonan objects to is the connection between the Scholastic theory of usury and the theory of the just price. He admits that there is a link between the concept of the just price and usury, but argues that “the problem of the just price is treated from an entirely different viewpoint than that from which usury is considered.”²⁹ He argues that the Scholastics effectively have two separate theories for two different types of transactions: a theory of usury for credit transactions, and a theory of the just price for all other exchanges. While it may be true that arguments against usury were not often framed in terms of a just price, his assertion that the difference between the two theories is “radical” seems to overstate the matter.³⁰ In the *Summa Theologica*, St. Thomas Aquinas places the question on usury (II-II.78) in his general discussion of justice and in the section on sins against commutative justice in particular, immediately following the question on cheating (II-II.77). Usury is clearly a sin against commutative justice, and the just price is the price that satisfies justice in commutations. In fact, in his question of merit (II-II.114), St. Thomas states that “it is an act of justice to give a just price for anything received from another,” a statement which logically includes money as well as goods and services. This suggests that the two theories are originally and essentially connected and not radically different or merely connected by a “thin, tenuous link,”³¹ though this is not to deny that Scholastic arguments against usury developed along very different lines than theories of the just price in other exchanges, which is perhaps Noonan’s essential point.

Conclusion

The source of the confusion regarding the Catholic teaching on usury is the changes in the practice of confessors that took place between 1820 and 1836. From the perspective of economic theory, these changes were entirely justified, as the effects of the Industrial Revolution created an abundance of investment, and the abolition of slavery transformed the risk faced by creditors and provided them with a valid title to compensation. There would have been no need to justify titles to *lucrum cessans* or *damnum emergens* by referring to the circumstances of the lender, since

²⁹ Noonan, p. 82.

³⁰ Noonan, p. 98.

³¹ Noonan, p. 82.

competitive markets would have meant that the value of these titles could easily be determined by market prices, i.e. the “common estimation” of those titles according to the just price theory.

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Appendix

Vix Pervenit

Encyclical of Pope Benedict XIV promulgated on November 1, 1745.

To the Venerable Brothers, Patriarchs, Archbishops, Bishops and Ordinary Clergy of Italy.

Venerable Brothers, Greetings and Apostolic Benediction.

Hardly had the new controversy (namely, whether certain contracts should be held valid) come to our attention, when several opinions began spreading in Italy that hardly seemed to agree with sound doctrine; We decided that We must remedy this. If We did not do so immediately, such an evil might acquire new force by delay and silence. If we neglected our duty, it might even spread further, shaking those cities of Italy so far not affected.

Therefore We decided to consult with a number of the Cardinals of the Holy Roman Church, who are renowned for their knowledge and competence in theology and canon law. We also called upon many from the regular clergy who were outstanding in both the faculty of theology and that of canon law. We chose some monks, some mendicants, and finally some from the regular clergy. As presiding officer, We appointed one with degrees in both canon and civil law, who had lengthy court experience. We chose the past July 4 for the meeting at which We explained the nature of the whole business. We learned that all had known and considered it already.

2. We then ordered them to consider carefully all aspects of the matter, meanwhile searching for a solution; after this consideration, they were to write out their conclusions. We did not ask them to pass judgment on the contract which gave rise to the controversy since the many documents they would need were not available. Rather We asked that they establish a fixed teaching on usury, since the opinions recently spread abroad seemed to contradict the Church's doctrine. All complied with these orders. They gave their opinions publicly in two convocations, the first of which was held in our presence last July 18, the other last August 1; then they submitted their opinions in writing to the secretary of the convocation.

3. Indeed they proved to be of one mind in their opinions.

I. The nature of the sin called usury has its proper place and origin in a loan contract. This financial contract between consenting parties demands, by its very nature, that one return to another only as much as he has received. The sin rests on the fact that sometimes the creditor desires more than he has given. Therefore he contends some gain is owed him beyond that which he loaned, but any gain which exceeds the amount he gave is illicit and usurious.

II. One cannot condone the sin of usury by arguing that the gain is not great or excessive, but rather moderate or small; neither can it be condoned by arguing that the borrower is rich; nor even by arguing that the money borrowed is not left idle, but is spent usefully, either to increase one's fortune, to purchase new estates, or to engage in business transactions. The law governing

loans consists necessarily in the equality of what is given and returned; once the equality has been established, whoever demands more than that violates the terms of the loan. Therefore if one receives interest, he must make restitution according to the commutative bond of justice; its function in human contracts is to assure equality for each one. This law is to be observed in a holy manner. If not observed exactly, reparation must be made.

III. By these remarks, however, We do not deny that at times together with the loan contract certain other titles-which are not at all intrinsic to the contract-may run parallel with it. From these other titles, entirely just and legitimate reasons arise to demand something over and above the amount due on the contract. Nor is it denied that it is very often possible for someone, by means of contracts differing entirely from loans, to spend and invest money legitimately either to provide oneself with an annual income or to engage in legitimate trade and business. From these types of contracts honest gain may be made.

IV. There are many different contracts of this kind. In these contracts, if equality is not maintained, whatever is received over and above what is fair is a real injustice. Even though it may not fall under the precise rubric of usury (since all reciprocity, both open and hidden, is absent), restitution is obligated. Thus if everything is done correctly and weighed in the scales of justice, these same legitimate contracts suffice to provide a standard and a principle for engaging in commerce and fruitful business for the common good. Christian minds should not think that gainful commerce can flourish by usuries or other similar injustices. On the contrary We learn from divine Revelation that justice raises up nations; sin, however, makes nations miserable.

V. But you must diligently consider this, that some will falsely and rashly persuade themselves-and such people can be found anywhere-that together with loan contracts there are other legitimate titles or, excepting loan contracts, they might convince themselves that other just contracts exist, for which it is permissible to receive a moderate amount of interest. Should any one think like this, he will oppose not only the judgment of the Catholic Church on usury, but also common human sense and natural reason. Everyone knows that man is obliged in many instances to help his fellows with a simple, plain loan. Christ Himself teaches this: "Do not refuse to lend to him who asks you." In many circumstances, no other true and just contract may be possible except for a loan. Whoever therefore wishes to follow his conscience must first diligently inquire if, along with the loan, another category exists by means of which the gain he seeks may be lawfully attained.

4. This is how the Cardinals and theologians and the men most conversant with the canons, whose advice We had asked for in this most serious business, explained their opinions. Also We devoted our private study to this matter before the congregations were convened, while they were in session, and again after they had been held; for We read the opinions of these outstanding men most diligently. Because of this, We approve and confirm whatever is contained in the opinions above, since the professors of Canon Law and Theology, scriptural evidence, the decrees of previous popes, and the authority of Church councils and the Fathers all seem to enjoin it. Besides, We certainly know the authors who hold the opposite opinions and also those who either support and defend those authors or at least who seem to give them consideration. We are also aware that the theologians of regions neighboring those in which the controversy had its origin undertook the defense of the truth with wisdom and seriousness.

5. Therefore We address these encyclical letters to all Italian Archbishops, Bishops, and priests to make all of you aware of these matters. Whenever Synods are held or sermons preached or instructions on sacred doctrine given, the above opinions must be adhered to strictly. Take great care that no one in your dioceses dares to write or preach the contrary; however if any one should refuse to obey, he should be subjected to the penalties imposed by the sacred canons on those who violate Apostolic mandates.

6. Concerning the specific contract which caused these new controversies, We decide nothing for the present; We also shall not decide now about the other contracts in which the theologians and canonists lack agreement. Rekindle your zeal for piety and your conscientiousness so that you may execute what We have given.

7. First of all, show your people with persuasive words that the sin and vice of usury is most emphatically condemned in the Sacred Scriptures; that it assumes various forms and appearances in order that the faithful, restored to liberty and grace by the blood of Christ, may again be driven headlong into ruin. Therefore, if they desire to invest their money, let them exercise diligent care lest they be snatched by cupidity, the source of all evil; to this end, let them be guided by those who excel in doctrine and the glory of virtue.

8. In the second place, some trust in their own strength and knowledge to such an extent that they do not hesitate to give answers to those questions which demand considerable knowledge of sacred theology and of the canons. But it is essential for these people, also, to avoid extremes, which are always evil. For instance, there are some who judge these matters with such severity that they hold any profit derived from money to be illegal and usurious; in contrast to them, there are some so indulgent and so remiss that they hold any gain whatsoever to be free of usury. Let them not adhere too much to their private opinions. Before they give their answer, let them consult a number of eminent writers; then let them accept those views which they understand to be confirmed by knowledge and authority. And if a dispute should arise, when some contract is discussed, let no insults be hurled at those who hold the contrary opinion; nor let it be asserted that it must be severely censured, particularly if it does not lack the support of reason and of men of reputation. Indeed clamorous outcries and accusations break the chain of Christian love and give offense and scandal to the people.

9. In the third place, those who desire to keep themselves free and untouched by the contamination of usury and to give their money to another in such a manner that they may receive only legitimate gain should be admonished to make a contract beforehand. In the contract they should explain the conditions and what gain they expect from their money. This will not only greatly help to avoid concern and anxiety, but will also confirm the contract in the realm of public business. This approach also closes the door on controversies-which have arisen more than once-since it clarifies whether the money, which has been loaned without apparent interest, may actually contain concealed usury.

10. In the fourth place We exhort you not to listen to those who say that today the issue of usury is present in name only, since gain is almost always obtained from money given to another. How false is this opinion and how far removed from the truth! We can easily understand this if we consider that the nature of one contract differs from the nature of another. By the same token, the

things which result from these contracts will differ in accordance with the varying nature of the contracts. Truly an obvious difference exists between gain which arises from money legally, and therefore can be upheld in the courts of both civil and canon law, and gain which is illicitly obtained, and must therefore be returned according to the judgments of both courts. Thus, it is clearly invalid to suggest, on the grounds that some gain is usually received from money lent out, that the issue of usury is irrelevant in our times.

11. These are the chief things We wanted to say to you. We hope that you may command your faithful to observe what these letters prescribe; and that you may undertake effective remedies if disturbances should be stirred up among your people because of this new controversy over usury or if the simplicity and purity of doctrine should become corrupted in Italy. Finally, to you and to the flock committed to your care, We impart the Apostolic Benediction.

Given in Rome at St. Mary Major, November 1, 1745, the sixth year of Our Pontificate.